RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $185 Annually
Registered with the Securities and Exchange Commission

November 19, 1980 **LETTER 796**

THE MARKET: The level of sophistication on Wall Street is rising year by year. And as it rises, technical analysis (or any other kind of analysis) gets more difficult. The easy approaches, the widely-followed approaches, they tend to malfunction, and it takes more intuition, more research, more sweat to track the course of the market.

I've often written that the market is a "living thing." It's a giant beast which, although made by the minds and actions of millions of investors, takes on a life of its own.

And like all living things, the market monster must breathe to live. I liken the breathing of the market to cycles of rise and fall. I've talked a good deal over recent months about the 233-day cycle. The page 2 chart (which has appeared here many times) follows the course of the 233-day cycle from 1976 to the present.

Each 233-day cycle is made up of two segments, a bull segment and a bear segment. I adjust the Dow to each cycle top and bottom, and the adjustments run as much as a few days to a few weeks. Thus, cycle analysis is not automatic or totally mechanical, and this is all to the good.

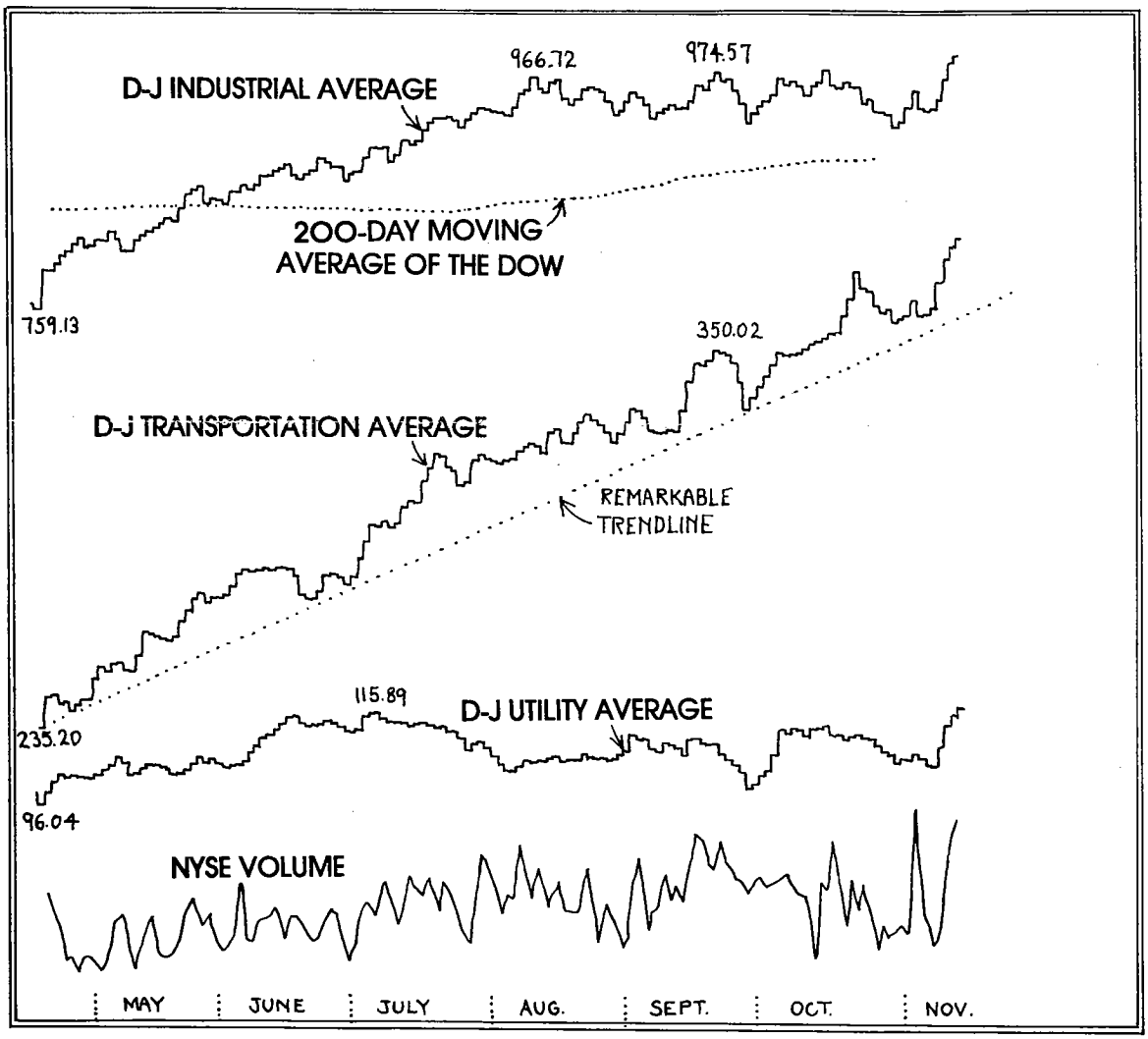
Nov. 6, DJIA 932.42; PTI 1339; A-D Ratio –17.40
Nov. 14, DJIA 986.35; PTI 1367; A-D Ratio –15.99

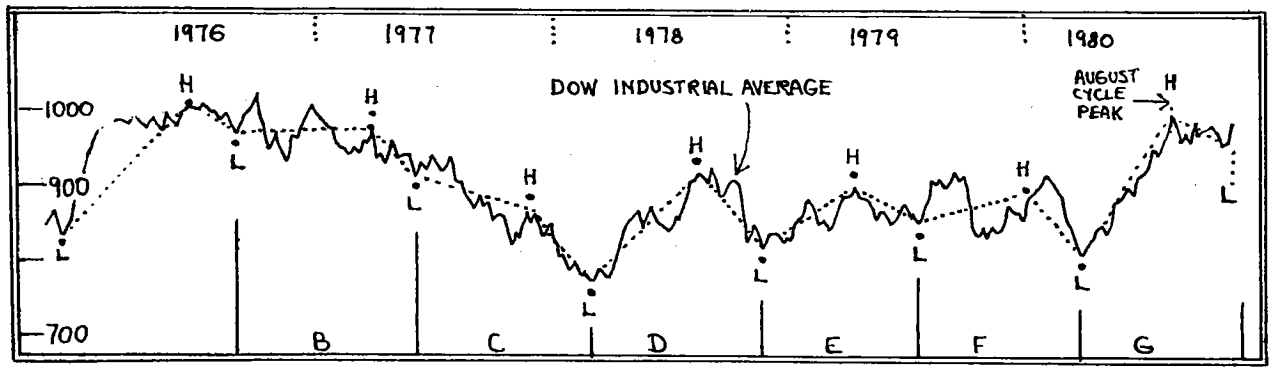
The bull segment of the latest 233-day cycle hit its high on August 15 at 966.72 for the Dow. And although the Dow pushed a bit higher (to 974.57 on September 22) that call was good enough for me.

Following the August 15 cyclical top I noted that the bottom of the bear segment of the cycle would be reached on November 10. Whether this was a perfect bull's eye for the cycle I cannot say at this time, but so far that certainly seems to be the case.

On November 11 the Dow jumped over 10 points, Transports over 9. November 11 saw a 20 point Dow explosion with the Transports up another 9—to an all-time record high of 386.29. Then on November 13 the Dow shot up 17 points to a three-and a-half year high of 982.42. In pushing to a new high, the Industrials confirmed the high in the Transportation Average and a major non-confirmation was erased.

I want to list a number of important events which have occurred since the August 15 cycle peak. (1) During the entire down-segment of the cycle, the Dow refused to break 900. That was impressive. It was particularly impressive because many analysts





had turned bearish, interest rates had rocketed up, and the economy seemed to be turning sour (the "double dip recession"). Yet, all this bearish sentiment was incapable of forcing the Dow below 900.

(2) During the August-November period of the bearish segment of the cycle, the PTI held steadily to its rising trend! This was extraordinary action, something that is rarely seen. The implication of this action is as follows: if the PTI continues to rise during the bearish segment of the 233-day cycle, what happens when the cycle turns up after November 10? The action following November 10 answers that question.

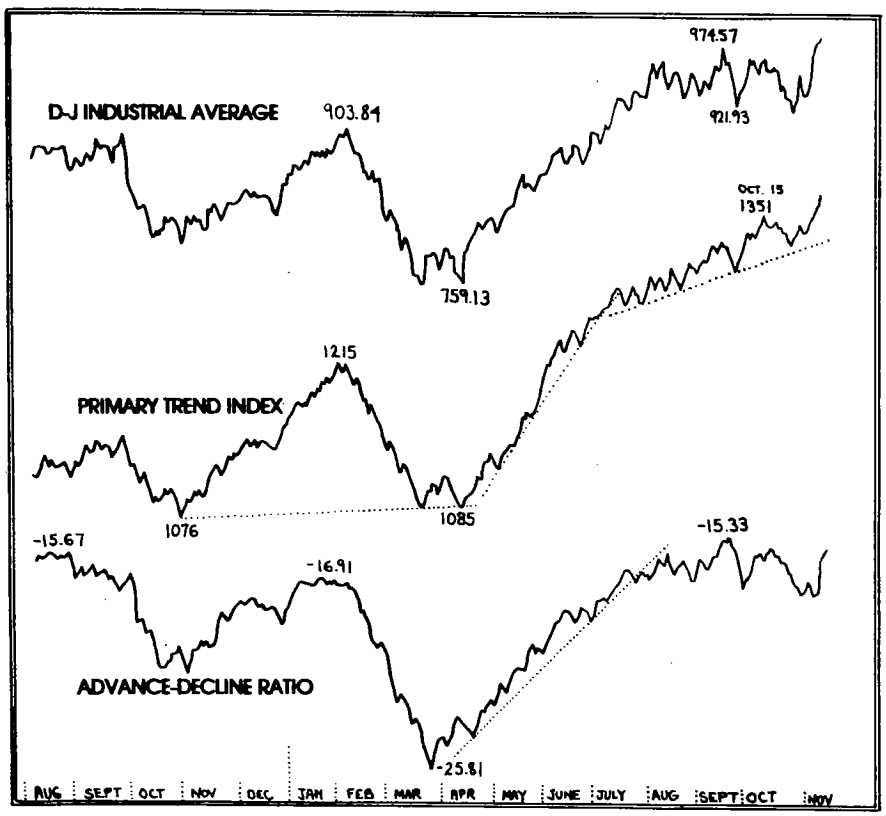
(3) On November 12 the NYSE index (all common stocks) and the Standard & Poor's broad 500 Stock Average both rose to record highs. That they could do this two days after the cycle turned up was remarkable.

(4) The great majority of investment advisories have been predicting a reaction or worse for the stock market. In truth (and I have documented this), there has been a lot of technical deterioration. Readers know about the divergence between the Dow and the Dow A-D line, the divergence between the Dow and the broad A-D ratio. Member trading has not been suggestive of a bull move, and certainly the put/call ratios have been negative. Yet, the market has shrugged all this off.

(5) There is no question about it, a lot of confusion has characterized the market of the past few months. But there is one place where confusion did NOT reign, and that was in my proprietary indicator, the Primary Trend Index (PTI).

To review, on April 21 the PTI turned up from a low of 1085. The PTI continued in a steep rising trend until mid-July. After mid-July the steep rising trend in the PTI gave way to a shallower rising trend. This shallow rising trend has been in force ever since mid-July despite the Mideast war, despite a 15.5% prime rate, despite sluggish business, and despite confusion about whether the nation is even out of the recession.

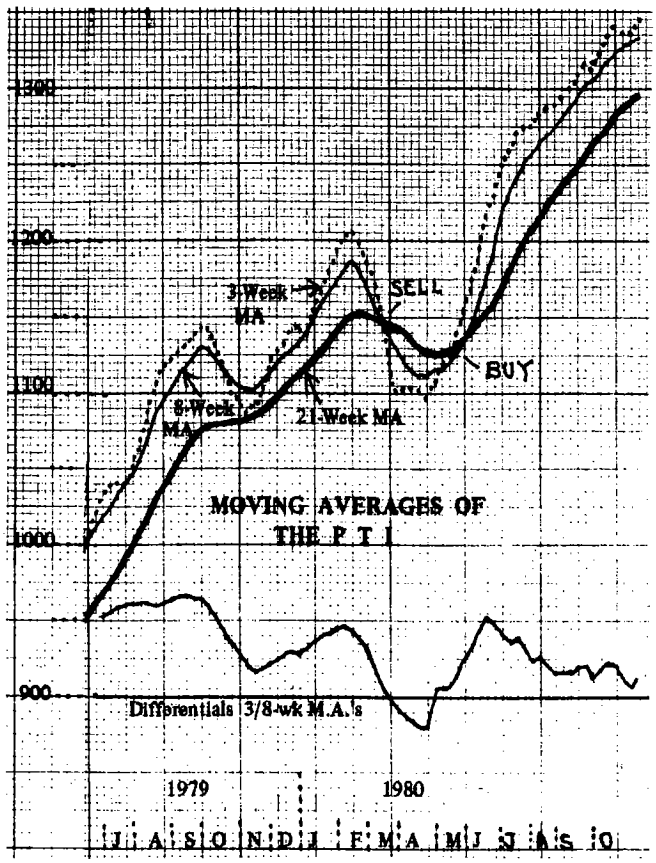
On November 12 the PTI rose to a **record high** of 1353! Thus, the PTI continues to fly in the face of the obvious (obvious bearishness), and it is saying loud and clear that market strength is still intact. I'll repeat what I've said many times before, I don't try to explain away the PTI, I don't apologize for the PTI, and I don't try to understand exactly what or why the PTI is saying what it is. I do compute it daily, I do chart it daily, and I include that chart with every Letter. My biggest mistakes have occurred when I disregarded the PTI or refused to believe what it was saying. As this Letter is written, the PTI continues to say "bullish" and that's going to be the word until the PTI reverses (i.e., turns down and holds below a declining trendline).



As a further aid, I occasionally publish three moving averages of the PTI as shown on page 3. The 3-week MA of the PTI is now 1335, the 8-week MA is 1329 and the 21-week is 1291. This is a bullish profile. At the bottom of the chart you see the weekly differentials between the 3 and the 8-week MA's, and the differential reached a peak on the week of June 19. The differentials have been retreating ever since, but significantly they never broke below zero (in other words, the 3-week MA never dropped below the 8-week MA). Last week the differential turned up again, along with the 233-day cycle.

Conclusion: All year I have been writing that the action in the various markets could be characterized by one word—*volatility*. First the gold market exploded to its 850 spike top, then interest rates shot to a spear-point top. Next commodities traced out their steeples, and now the stock market is forming a spike.

With it all, it does not pay to be too cute or overly-sophisticated about the current market situation. A record 75.7 million shorts are now positioned against the averages and against the Primary Trend Index. With most of the averages (Dow excepted) and the PTI at record highs, the situation could be set for a brutal short squeeze. Exactly how and in



what form the move in stocks will develop, no one knows, but I would advise subscribers to follow the PTI closely. The longer the rising trend in the PTI (it's been 7 months so far), the more importance the rising trend assumes. The broad sweep of the market must be considered bullish as long as the PTI trendline is intact.

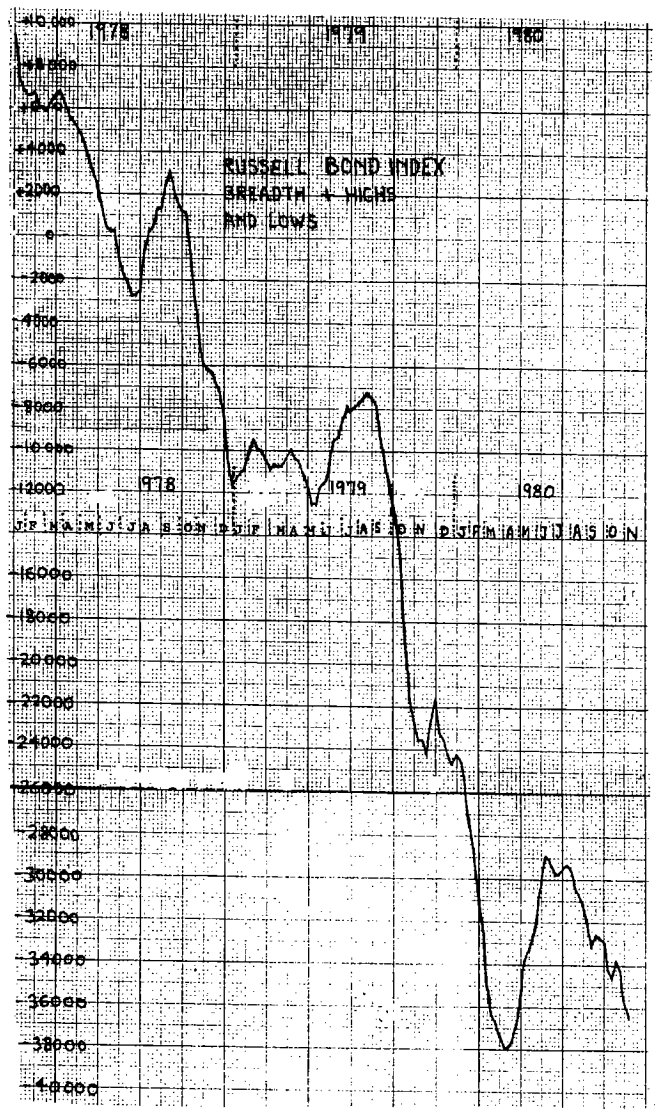
As for the Averages, all that remains is a potential two-step progression for the Dow. This may be more difficult than we know, but the first step would be a decisive move above 1000. The next step would be a bettering of the all-time Dow high of 1051.70 (recorded in 1973). If 1051.70 is hurdled, I would expect a "running of the shorts" of historic proportions.

In closing this section I want to advise all subscribers to curb their greedy impulses and act with moderation. Remember, the US has now followed England, and whereas England's answer to inflation and decay was Margaret Thatcher, our answer is Ronald Reagan. England is now in a severe business slump, government spending in England is up an astounding 25% over last year, unemployment is high, and presumably the British are taking a bit of their medicine. If the US is to begin to attack its rot, it too will have to take copious quantities of bitter medicine. In time the stock market will understand this. That recognition will ultimately be signaled when the PTI turns (decisively) down.

On numerous occasions I have suggested that the easiest way to participate in this market is through good mutual funds with "switch capabilities." The switch allows you to move into cash and back to stocks rapidly and with no expense, no commissions. On top of that, it is my opinion that a good fund will outperform most "good" stock selections. Two funds I like are *Mutual Shares Corp.*, 170 Broadway, NYC 10038 and *Fidelity Equity Fund*, 82 Devonshire St., Boston, Mass 02109 (800-225-6190).

INTEREST RATES: From all quarters we hear that interest rates "have topped." Maybe, but I'm not convinced. The Muni bond yields have hit new all-time highs above 10% and Muni's have shown little bounce. The long-term Government bonds are flirting with their all time lows, but they have not yet broken below their April lows. My "Russell Bond Index" of NYSE bonds (highs and lows, advances and declines), as shown, has sunk to just above its April low, but it has not broken to new lows.

Nevertheless, I am still a bit worried here about the money markets, and I recommend mostly short-term vehicles (T-bonds, money market funds) with only pilot positions in the medium to long-term bonds. Mind you, if the Russell Bond Index holds above its 1980 low (minus 3800) and gives us hints of a real turn, I will be the biggest bond bull around. But I want to see more, I want to see some base building, I want to see new issues snapped up instead of seeing dealers choke on every new issue. There will be a lot of money made in bonds one of these days. But so far, the yellow light is still flickering.



THOUGHTS, NOTES, QUOTES: The US seems finally to have conquered its "death wish" and has given Carter and Co. their walking papers. The very best you might say for Carter is that he was "well meaning," but even that is open to question. From the look of hatred in his eyes during the Great Debate, I found myself wondering what this soft spoken man was really

thinking about. If looks could kill, Reagan would be a corpse today.

So it's "up, up and away" for Ronald Reagan, and I wish him all the luck in the world. The people have said "enough" with the strongest weapon they have at their command–the vote. And Reagan has what almost constitutes a mandate as he prepares to take over the oval office.

Again, I want to remind subscribers that no man can produce miracles. Reagan can kick out the Keynesians, he can try to pare down government, he can even try to jettison whole departments such as Energy and Eduation. But the one thing he cannot get rid of is DEBT. The debt is still growing, and so is the cost of servicing it. Furthermore, additional huge chunks of debt are already included in the 1981 budget (best estimate for 1981–a $70 billion deficit). It's a gathering disaster, and I firmly believe that the debt situation is now beginning to destroy the US economy.

The fact is that the US debt is so enormous that the problem of servicing it and providing for additional funds is taking on a life of its own. It's become a Frankenstein monster. If you don't provide enough new money, the situation is automatically deflationary. And if you do provide enough money, the situation is inflationary. In the face of this dilemma, the markets (bonds, stocks, commodities) are whipped back and forth as the opposing forces of inflation and deflation lock and unlock their grip on the hapless US economy.

The instability created by the debt monster has literally obliterated the concept of long term investing. Now it is a question of catching the swings, jumping on the rallies and bailing out of the declines. There's no chartable financial future, there's no planning or strategy for saving. So far the future seems to be debt and more debt. And the choice is "inflate or die." It's a very difficult situation Ronald Reagan has chosen to preside over, and he'll need all the brains, luck and skill and backing he can muster.

* *

The current issue of Atlantic contains a fascinating article by a Soviet intelligence worker (a woman) who defected. Her description of that paranoid society will make your blood run cold. Speaking of the Soviets, here's a little description of the now all-but-forgotten Afghanistan and what the Russians have done in that sad nation!

By THE ASSOCIATED PRESS

"More than a million innocent people, including women and children, have been killed" in Afghanistan since Soviet troops moved in 10 months ago, says Afghanistan's former UNESCO delegate, who defected to West Germany last weekend.

In an interview published today in the West German newspaper Bild, Mohammed Paktiawal was quoted as saying that since the first pro-Moscow Marxist government seized power in Kabul in 1978, "16,000 intellectuals, students, academics and business leaders have been executed in the central prison in Kabul."

A final note on the Russians: just in case you think they're looking for "parity" in arms or peace, study this statement by their Defense Minister:

MOSCOW (UPI)—Defense Minister Dmitry F. Ustinov, in remarks apparently aimed at President-elect Ronald Reagan, warned Friday that the Soviet Union will never take second place to America in military might.

Ustinov's comments, delivered as hundreds of tanks and missile carriers rolled by in Red Square in celebration of Revolution Day, contrasted sharply with the olive branch offered to the incoming U.S. administration just the day before.

Ustinov did not mention Afghanistan, although a banner in the civilian parade after the military review hailed the two nations' "relations of brotherhood, revolutionary solidarity and all-around cooperation."

* *

Women's Wear Daily (the Bible of ready-to-wear and textiles) is rather happy about the election. They write, "Say good-bye to Grits and Fritz, to jogging on the White House lawn and to endless reports on the view from Amy's treehouse... This will be a much more international city again. It will be easier for ambassadors to entertain because these people (Reagan's) will go out and be much more accessible...the new administration will probably be far more informal than those of previous Republican Presidents. Nine-to-five workdays in the Oval Office, Frank Sinatra crooning in the Blue Room and horseback riding on the Potomac are all distinct possibilities... There will be an influx of West Coast big rich." For all of this, Women's Wear seems ecstatically ready!

* *

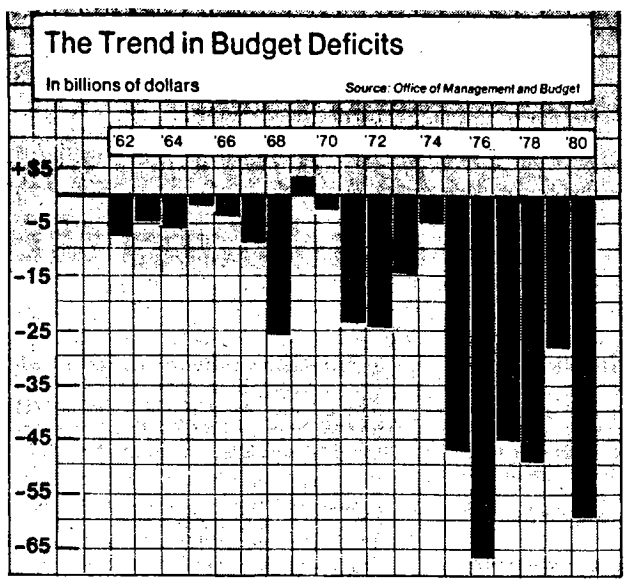
Week's most symbolic resignation: say bye bye to Alfred Kahn, Jimmy Carter's chief "inflation fighter."

* *

"Ponder this one" Dept: Jimmy Carter was the first Democratic President in 92 years to lose a re-election bid.

* *

"One Picture is Worth a Thousand Groans" Dept: Here's what the trend in US budget deficits looks like. The latest (1980) deficit was $59 billion PLUS $14.2 billion in "off budget" deficits for a total of $73 billion. Interest or service charge on this one year's deficit – about $8.7 billion! How's that for adding on to the rising totals of "never-to-be-paid-back" debt.



The New York Times / Oct. 30, 1980

* *

Fascinating Statistics Dept: US oil industry drilled 18,645 oil wells during the first 9 months of 1980, up 40% from 1979.

Meanwhile, US imports of crude oil plummeted 31% from 1979! ...Total US property values hit $1.68 trillion in 1979, 11.8% above 1978.

NEW ORLEANS: Well, I got back from New Orleans all in one piece. I had a good time. I talked with actor Chuck Conners (a true hard money man), I met Nelson Bunker Hunt and kidded him about all his new-found publicity, I had dinner with the one and only Harry Browne (who, at a single sitting, demolished a steak plus a whole lobster), and I got through a few New Orleans creole meals on my own (but believe me, you'll live longer if you stay with the salad bars). Not many joggers in New Orleans; I was out there jogging at 6 in the morning, and I had the feeling that on-lookers thought somebody was chasing me.

I listened to a lot of speeches at the Conference, and in my own speech I opined that gold was now in a bear market with the strong probability that 600 would not hold. The usual arguments raged, basically inflation vs. deflation, I didn't think either group won the argument. My own sentiments (along with Dines, Myers) is that ultimately deflation will rule. I cannot see this nation giving in to inflationary destruction. Many countries (including this one) have withstood the ravages of chronic deflation. But going back over history, no nation has been able to stand in the face of rampant, continuing inflation.

GOLD: One of the hardest things to do in investing is to avoid biases, prejudices and emotional attachments. In other words, you can't kid yourself when it comes to stocks, bonds, commodities – or gold.

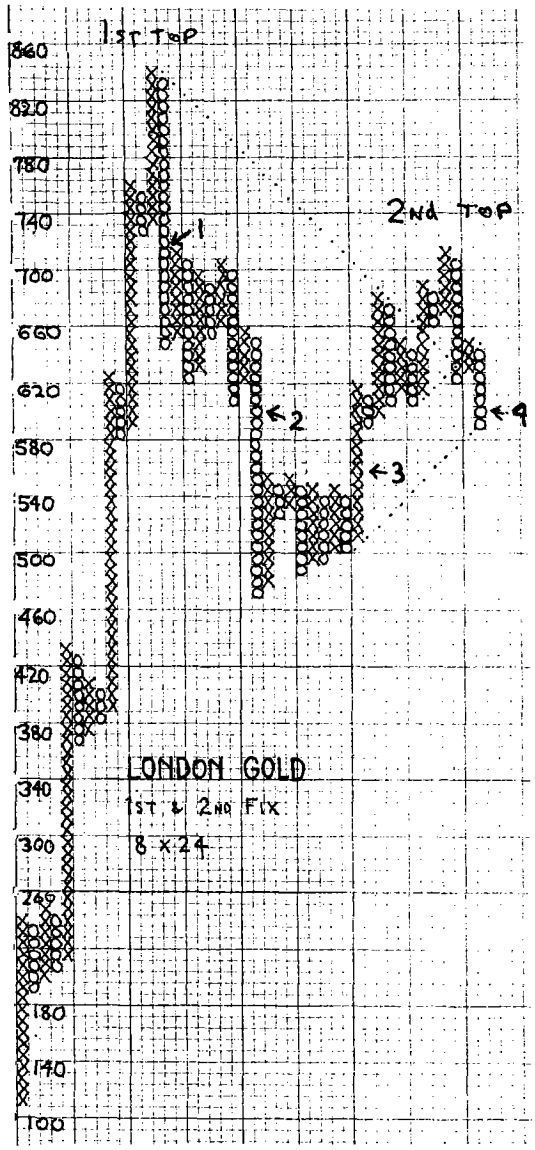
Gold is an exquisite metal, and I'd love gold backing behind every dollar I own. But as for gold as an investment, I don't "love it" any more than I love soy beans, General Motors or 91-day T-bills. From a market standpoint, gold, like anything else, can only do two things – it can go up, and it can go down.

Study the accompanying 8x24 point and figure chart of gold. Here's a chart that offers great perspective since it traces every major gold move since 1976. Each box on this chart equals 8 points, and only rallies or declines of 24 points or more are depicted.

What I see on this chart bothers me. I see a pattern that I have never liked, and the pattern is this: first a major top. Then an important decline. Next a secondary top below the first top. Finally, a period of distribution on the second top. In all honesty, this is the formula for a bear market, and it seems to me that gold could be in a bear market now.

Following the spike-peak at 850, gold turned down and at the 724 box (arrow 1) the metal turned bearish. At 604 (arrow 2) the downtrend was reconfirmed. A period of consolidation followed at which time I turned bullish again on gold. At 564 (arrow 3) gold turned bullish again, and this rally took gold to a peak of 720. From this second (lower) peak, gold turned down. When gold touched 604 on the downside (arrow 4) this chart turned decidedly bearish. The metal dropped to a low last week of 596, then rallied.

But on a cold reading of this chart, my opinion is that gold is now in a bearish trend and perhaps moving within a major bear market. It is obvious that the 600 level offer important technical

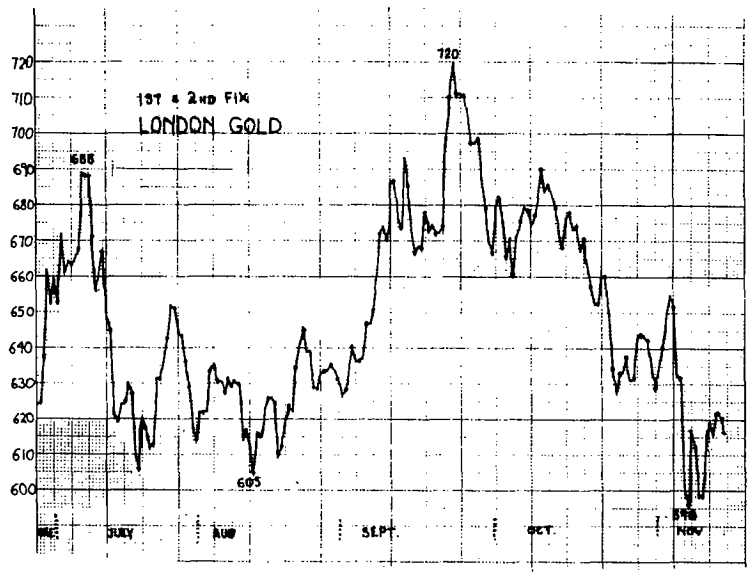


and psychological support. It is my opinion that the last bullish sentiment for gold would crumble with a decisive breaking of the 600 level.

I show on page 6 my daily chart of gold, a chart showing the 1st and 2nd London fix (so there are two entries for each day). The chart shows that in November (last week) gold broke temporarily below the 600-605 support area, but so far support has come in at 600.

One interesting facet of the current gold picture is that although gold has come down over 120 points since its September high, the open interest for gold in the futures market is still near record highs. This usually means that despite losses, most speculators have held their positions (as positions are closed, the open interest tends to decline). As a rule, an open interest that holds high despite declining prices is not a bullish manifestation, and I am watching to see if gold contract holders get discouraged and exit the futures market (which would tend to bring the open interest down).

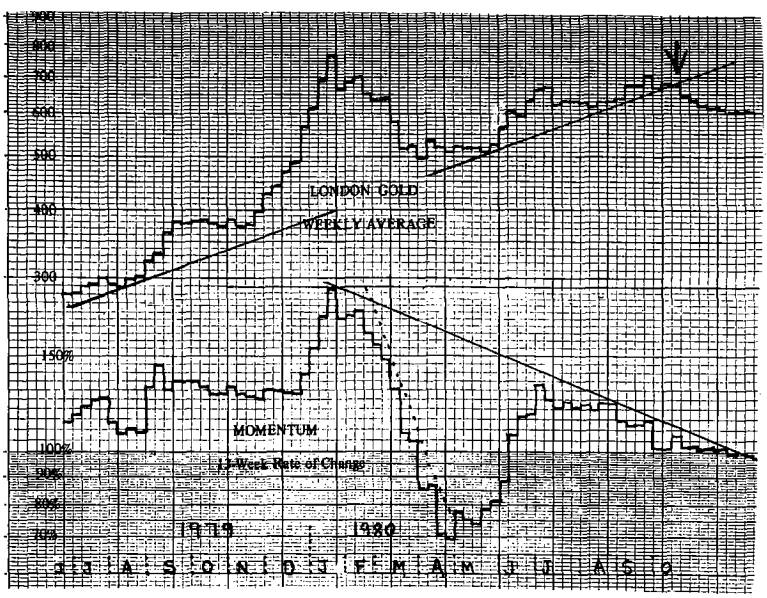
FOR NEW YORK SUBSCRIBERS: In accordance with the New York Investment Advisers Act, we have filed our Investment Advisor Statement and New York subscribers may obtain a copy of same upon request. A fee of $14 will be charged for xerox costs.



I can think of two factors that separate gold from any other investment, and I want to discuss them. First, gold is part of the reserves of the leading central banks. It is to the banks' advantage to have gold hold at a high price. Therefore, there could be a good deal of support on any break to or below 600. No bank wants to see the value of its reserves go down under market pressure.

Second, I believe that ultimately, the price of gold will have to be raised (officially) as the Free World attempts to bail itself out of a major depression. Raising the price of gold during a depression (as in 1934) allows a nation to re-inflate. This is a long way off, but it is a reason for holding a certain portion of one's assets in gold no matter what. It has been said that war is too important to be left to the generals. By the same token, many wealthy investors believe that gold is too important to be traded on the basis of intermediate swings of a hundred or so points.

The 5-week moving average of gold (see chart, last Letter) is now 631, 13 points *below* the 13-week MA, which stands at 644. The long-term or 50-week MA is now 578. Thus spot gold is about 40 points above its 50-week MA, the closest it's been since early 1979. Thus, I would say that it is very important, technically, for gold to hold above the 578-600 level. Gold has now dropped below the halfway (50%) level of its 1980 decline (i.e. 850 to 474). So, technically, it could be in for trouble ahead, and the best and strongest level of resistance is 600. The longer gold holds above 600 the better, particularly if bullish sentiment towards gold can simmer down (I would prefer that gold sentiment turn bearish while gold holds above 600).



Gold momentum (13-week rate of change) dropped to 99 on the week ending November 14 (see chart). This is the first below-100 reading since last June. Here again, it would be a plus for gold if the momentum readings would tend to hold to 100 or better.

LATE NOTES: On Friday, November 14, the Fed boosted the discount rate 1% to 12% (this is just under the record high of 13%). But the Fed stiffened the boost by raising it an additional 2% (to 14%) for large banks that come to the Fed window too often. Thus, the Fed is seriously attempting to slow bank lending activity, particularly in the face of booming bank loans.

As I see it, the defense industry is moving towards white hot activity (sub-contractors will be booming soon) while the rest of the economy will be squeezed. This is what I've been predicting all along. If Russia had to sacrifice its civilian economy to build a mighty war machine, how are we going to try to catch up to Russia and at the same time sustain a civilian-economy boom? No, it's not going to be guns and butter in the US. During the Carter regime, it was butter. During the Reagan years it's going to be guns. And I don't think there is any choice–unless we're willing to be a Russian satellite.

TELL THEM: A lot of Republicans read these Letters, and I imagine President-Elect Reagan sees them occasionally. At any rate, I want to say one thing that may help, and it's something I have insisted for many years. I said the day that Carter took office that he should tell the American people the bitter truth about the economy, about the debt, about the near-bankruptcy of the US on an assets-to-debt comparison. I know that Americans would make whatever sacrifices were necessary if only they believed that their leader would tell them the truth. Carter never spoke the truth. His utterances were a maze of political wishes and devout dreams.

Now Reagan is about to take the reins. The nation is in worse shape, the debt is much higher (as is inflation) than when Carter took over. Reagan's first act, his very first act, must be to tell the people the truth about our situation. Tell them the debt is almost unmanageable, tell them that drastic sacrifices will be necessary, tell them that the wasteful standard of living of the 1950's to 1980's is over, tell them that the nation is moving into the final chapter of the greatest debt and spending orgy in world history.

If Reagan does not START with the truth, if he does not honor the American people with the utter truth of the situation, then I predict that his Administration will end the way all lying Administrations must end – in defeat. Think about it; Kennedy was killed, Johnson was forced out of office, Nixon was thrown out of office, Ford was voted out of Office, Carter was swept out of office. The only way for Reagan to bring honor to his Presidency is to forget politics and tell the people the truth. Reagan owes no one anything. The people suspect the truth, but they want to hear it from their leader – then they will make the sacrifices. Now it's the truth or disaster – that I firmly predict.

NEXT MAILING: December 3rd